Oral Statement of
Chairman James J. Hoecker
Federal Energy Regulatory Commission
before the
Subcommittee on Energy Research, Development, Production and Regulation
Committee on Energy and Natural Resources
United States Senate

October 5, 2000

Mr. Chairman and Members of the Subcommittee:

Good morning. I am James Hoecker, Chairman of the Federal Energy Regulatory Commission. Thank you for inviting me to participate in today's hearing on the challenges facing the electricity markets in the Northwest.

This is a transformational period for this large and critically important industry. After almost a century of heavy cost of service regulation, dominance by vertically integrated monopolies, and highly localized markets for power, the country is moving toward electricity competition and regional integration. This change comes with many new and often unanticipated challenges. And it comes at a moment when our vigorous economy is demanding more power, creating more numerous bulk power transactions, and placing stresses on the transmission grid that we have not seen before.

The Pacific Northwest is a unique power market in many respects. For example, the Northwest region obtains much of its electricity from hydroelectric generation, a resource whose availability varies considerably by season and from year-to-year. Moreover, much of the region's electricity is sold by a flagship federal utility, the Bonneville Power Administration. Bonneville also controls over 70% of the region's total transmission system. The region also has the Northwest Power Planning Council, a multi-state regional body considering regional electricity issues. As evidenced by Dr. Kavier's testimony. This body provides a thoughtful, regional perspective on power market issues.

On the other hand, the region's challenges are not dissimilar from those experienced elsewhere. And physically, the Northwest utilities are part of a large and highly integrated electrical system known as the Western Interconnection. This interconnection includes 1.8 million square miles within 14 western states and parts of Canada and Mexico and includes 65 million people. These physical factors and regulatory developments suggest that the events of this summer should be viewed in a western, if not a national, context.

During several periods this summer, the Northwest experienced an upturn in spot market prices for electricity sold at wholesale. Spot prices in the Northwest were generally lower at other times this summer; yet they tended to exceed historical levels. The Northwest is heavily involved in seasonal purchases or sales of power with California.

As you know, wholesale price increases also occurred this summer in California and, due to the operation of California law, were flowed directly through to retail customers of San Diego Gas & Electric. I would note that the California and Northwest wholesale markets are different in many respects, largely because California is four years into a complete restructuring of its power markets. The California investor-owned utilities have divested much of their generation capacity. California has a centralized power exchange and requires investor-owned utilities to purchase power through this exchange. California's market mechanisms settle transactions at a single price instead of individually negotiated prices in bilateral contracts. And, its utilities have not been allowed, or otherwise have not chosen, to undertake long-term contracts or other price hedges.

My preliminary view is that California's price volatility stems in part from a fundamental imbalance between high demand in California and throughout the West due to economic growth and unusually warm weather combined with minimal additions to generation capacity in recent years. Supplies of power are simply inadequate. A number of other factors contributed in varying degrees to the price volatility in California:

- Unusually large power purchases in the spot market, which often has higher prices, instead of purchasing power under long-term contracts or hedging their purchases.
- A lack of incentives for retail customers to reduce their usage during peak hours when electricity cost are highest.

- Under-scheduling of purchases, requiring the ISO to obtain power for purchasers at the last minute.

- Wholesale market rules that may not work efficiently.

- High natural gas prices.

At this moment, the pricing events in California and the Northwest appear to be related, but we need to know more. Without prejudging pending investigations, it appears to me that the price increases in the Northwest this summer could have been caused by factors not unlike the fundamental problems in California: (1) the Northwest region experienced record and near-record high temperatures during parts of June 2000; (2) regulated flows and electrical output at hydroelectric facilities in the region were lower than normal in June; (3) a significant amount of generating capacity was out of service for various reasons; (4) natural gas prices have increased, raising the cost of running natural gas generating units; and (5) additions of new generation facilities have not kept pace with the region's growing demand for electricity.

In response to price volatility in California, the Northwest, and the Northeast this summer, the Commission has directed its staff to investigate wholesale market conditions in various parts of the country and to determine what technical or operational factors, regulatory rules, market rules, market conduct, other factors affected the levels of electric prices and the reliability of service. The Commission instructed staff to report its findings to the Commission by November 1, 2000. I expect that these investigations will allow the Commission to act quickly to help stabilize California's power markets and create the proper environment for continued investment in that state and the West.

In the meantime, Mr. Chairman, the Commission continues to work hard to implement regional transmission organizations, as noted in my written testimony. It is my personal view that the Commission cannot and must not allow that process, and the benefits to our Nation that will come from it, to be delayed a day longer than necessary. If utilities do not take the opportunity offered in Order No. 2000 to restructure their operations to promote bulk power competition, then I think we must redouble our efforts at the Commission. Moreover, the next Congress needs to support legislation that endorses RTOs and other fundamental industry changes. For now, I am pleased to say that the utilities and the stakeholders in the Northwest, in working to create a viable RTO, have exhibited a level of vision and hard work that other regions would do well to emulate.

Thank you for holding this hearing. I will be happy to respond to your questions.